NATIXIS

CREDIT NEWS

10 June 2016

Banks

Credit impact : -

Spreads impact : -

MREL scenarios: what is the shortfall?

While the TLAC has already been calibrated, this is not the case for MREL. We assumed various scenarios and it emerges that the requirements are significant, and what is more, greater than those relating to the TLAC (as a result of the formula that we anticipate for the MREL). The uncertainties related to MREL is increased by (i) potential changes to the hierarchy of creditors in certain European countries (cf. Netherlands, Sweden) and (ii) the potential creation of asset classes eligible for inclusion in TLAC/ MREL.

TLAC and MREL: 2 ratios, 1 goal: loss absorption by bondholders

These two ratios have different names but are both made of liabilities that are easy to bail-in. **The underlying principles are also identical, geared towards a doubling of regulatory requirements (although version 2022 of TLAC, the result of much compromise, seems to diverge slightly from this idea).** These ratios are based on the following rationale: all banks should be able to 1/ absorb losses and 2/ recapitalise themselves up to the minimum required level under Pillar 1 (8% of RWAs -Pillar 1 total cap ratio- and 3% in terms of leverage exposure), including the Pillar 2 buffer and the Combined Buffer if necessary.

MREL calibration still an unknown: loss absorption by bondholders

TLAC calibration is known (16% and then 18% in terms of RWAs, 6% and then 6.75% in terms of leverage) but MREL calibration has yet to be defined and depends on various parameters. The eligible instruments have not yet been established, nor has a common level for all European banks under the supervision of regulatory authorities. **Working groups have in the past mentioned a benchmark equal to 8% of the total balance sheet, which has left quite an impression, but the SRB and the European Commission pointed out that this was a reference point rather than an obligation.** Cases will be examined individually. **Similarly, the recent comments by Elke König (in charge of the SRB) point to a higher calibration, and the work of the Authorities suggests that ultimately MREL will be expressed in terms of RWA and leverage exposure, rather than balance sheet size**. Regarding this subject, we invite readers to read our regulatory presentation (page 25) for further information.

A lingering process apparently delayed by UK-Germany vs France-Italy

Uncertainty ramps up as the many stakeholders involved in the process of determining MREL jitters on prospects final calibration could be harming their funding strategy and their efforts. **UK-Germany teamed up against France-Italy** (according to Bloomberg and the FT which cites people familiar with matter), **the former aiming at safeguarding progress made up to now**, i.e. juniorization and issuance through NOHC, **while the latter lobbies to cap the regulatory inflation as much as possible (in particular by capping the need for readily bail-in-able liabilities at 8% of balance sheet, which is strongly opposed by UK & Germany)**. **In our view, the UK-Germany approach will eventually prevail, in other words, the benchmark of 8% of BS has to be seen as a minimum, rather than a maximum.** This is in line with the latest comment by the SRB (Elke König)

Time is ripe to shed light on calibration

On the next page, we detail, step by step, the methodology we used in assessing the potential shortfalls for a sample of major banks in continental Europe adding up the 2 capital stacks Pillar 1 and Pillar 2 multiplied by 2 AND on top of that, the Combined buffer (requirement and guidance), bearing in mind this approach yields stringent, yet realistic and consistent requirements, in our view. **We can see that the shortfalls are considerable and, most importantly, greater than those linked to TLAC (as a result of the formulation that we expect for MREL)**. The usual suspects need to issue relatively large amounts on the back of the introduction of the MREL, supposed to be phased-in from 2019 onwards.

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Our MREL Scenario

MREL	… expressed as a % of RWA					… expressed as a % of leverage exposure				Current				Additional MREL-eligible bonds**	MREL shortfall based on Lev. exp.	MREL shortfall based on RWA	MREL shortfall
Bank	Pillar 1 (A)	Pillar 2 (B)	(A+B)*2	Combined buffer (C)	Total (C)+(A+B)*2	Pillar 1 (D)	(D)*2	Combined buffer (E)	Total (D)*2+(E)	Total capital ratio FL	Leverage ratio FL	Total lev exposure	Total RWA				
Deutsche Bank	8%	3.25%	22.5%	4.5%	**27.0%**	3% ?	6% ?	1% ?	**7% ?**	**14.7%**	3.4%	1,390	401	51	-	-	**-**
Commerzbank	8%	3.25%	22.5%	4.0%	**26.5%**	3% ?	6% ?	1% ?	**7% ?**	**15.4%**	4.5%	525	195	14.82 ****	-	**6.8**	**7**
MPS	8%	3.20%	22.4%	2.5%	**24.9%**	3% ?	6% ?	1% ?	**7% ?**	**15.2%**	5.1%	165	72	possibly***	3.1	**7.0**	**7**
Unicredit	8%	2.75%	21.5%	3.5%	**25.0%**	3% ?	6% ?	1% ?	**7% ?**	**14.0%**	4.4%	1,014	394	possibly***	26.2	**43.5**	**43**
Banco Popolare	8%	2.55%	21.1%	2.5%	**23.6%**	3% ?	6% ?	1% ?	**7% ?**	**11.8%**	4.4%	120	45	possibly***	3.1	**5.3**	**5**
Credit Agricole Group	8%	2.50%	21%	3.5%	**24.5%**	3% ?	6% ?	1% ?	**7% ?**	**18.1%**	5.5%	1,379	509.0		20.7	**32.6**	**33**
CASA	8%	2.50%	21%	2.5%	**23.5%**	3% ?	6% ?	1% ?	**7% ?**	**17.6%**	4.4%	947	304.3		**24.6**	18.0	**25**
BNP Paribas	8%	2.50%	21%	4.5%	**25.5%**	3% ?	6% ?	1% ?	**7% ?**	**13.9%**	4.0%	1,724	627		51.7	**72.7**	**73**
SocGen	8%	2.50%	21%	3.5%	**24.5%**	3% ?	6% ?	1% ?	**7% ?**	**16.4%**	4.0%	1,193	351		**35.8**	28.4	**36**
Santander	8%	2.50%	21%	3.5%	**24.5%**	3% ?	6% ?	1% ?	**7% ?**	**13.5% ***	4.8%	1,338	572		29.4	**63.0**	**63**
BBVA	8%	2.50%	21%	3.5%	**24.5%**	3% ?	6% ?	1% ?	**7% ?**	**15.0%**	6.4% *	749	399 *		4.5	**37.9**	**38**
Intesa	8%	2.50%	21%	2.5%	**23.5%**	3% ?	6% ?	1% ?	**7% ?**	**17.4%**	6.7%	593	282	possibly***	1.8	**17.2**	**17**
ING	8%	2.50%	21%	5.5%	**26.5%**	3% ?	6% ?	1% ?	**7% ?**	**17.5%**	4.3%	1,093	315		**29.5**	28.4	**30**
UBI	8%	2.25%	20.5%	2.5%	**23.0%**	3% ?	6% ?	1% ?	**7% ?**	**13.9%**	6.0% *	122	61	possibly***	1.2	**5.5**	**6**
Caixabank	8%	2.25%	20.5%	2.8%	**23.2%**	3% ?	6% ?	1% ?	**7% ?**	**15.9% ***	5.3%	385	138		6.5	**10.1**	**10**
Mediobanca	8%	1.75%	19.5%	2.5%	**22.0%**	3% ?	6% ?	1% ?	**7% ?**	**16.2%**	11.6%	65	60	possibly***	-	**3.5**	**3**
CM11-CIC	8%	1.25%	18.5%	3.0%	**21.5%**	3% ?	6% ?	1% ?	**7% ?**	**17.9%**	5.7%	510	193		6.6	**6.9**	**7**
Sum										.							**402**

NB: The data in shaded grey on the right of the table shows what type of requirement is the most demanding (RWAs or leverage).
1 DB/CMZB: We include here retroactively juniorised German senior debt based on the government's 2015 proposal
2 SAN: MPE (multiple point of entry) approach, an indicative illustration based on a SPE approach
Source: Bank data, Natixis

How do we calibrate? *

Here we estimate MREL-eligible liability shortfalls assuming the ratio is calculated based on a doubling of requirements under Pillars 1 and 2 (8% total capital ratio, common to all banks), to which we added the Combined Buffer albeit without doubling it. To summarise, we provide the formula applied to the data below:

1. In terms of RWA: (8% + Pillar 2) * 2 + Combined Buffer (countercyclical / conservation / systemic buffers).
2. In terms of leverage exposure: 2 * 3% or X% + any-would be Combined buffer translated in Leverage exposure when applying

MREL shortfalls based on various leverage ratio calibrations

MREL	MREL shortfall as a % of RWA *	Calibration of leverage ratio at 3%+1%						… calibration at 3%+2%			… calibration at 5%		
Bank		Pillar 1 (D)	(D)*2	Combined buffer (E)	Total (D)*2+(E)	MREL shortfall as a % of Lev exp.	MREL shortfall	Total (D)*2+(E)	Leverage ratio FL	MREL shortfall	Total (D)*2+(E)	Leverage ratio FL	MREL shortfall
Deutsche Bank *	-	3%	6%	1%	**7%**	-	**-**	**8%**	**12.9**	**13**	**10%**	**40.7**	**41**
Commerzbank *	6.8	3%	6%	1%	**7%**	-	**7**	**8%**	3.6	**7**	**10%**	**14.1**	**14**
MPS	7.0	3%	6%	1%	**7%**	3.1	**7**	**8%**	4.8	**7**	**10%**	**8.1**	**8**
Unicredit	43.5	3%	6%	1%	**7%**	26.2	**43**	**8%**	36.3	**43**	**10%**	**56.6**	**57**
Banco Popolare	5.3	3%	6%	1%	**7%**	3.1	**5**	**8%**	4.3	**5**	**10%**	**6.7**	**7**
Credit Agricole Group	32.6	3%	6%	1%	**7%**	20.7	**33**	**8%**	**34.5**	**34**	**10%**	**62.1**	**62**
CASA	18.0	3%	6%	1%	**7%**	**24.6**	**25**	**8%**	**34.1**	**34**	**10%**	**53.1**	**53**
BNP Paribas	72.7	3%	6%	1%	**7%**	51.7	**73**	**8%**	69.0	**73**	**10%**	**103.5**	**103**
SocGen	28.4	3%	6%	1%	**7%**	**35.8**	**36**	**8%**	**47.7**	**48**	**10%**	**71.6**	**72**
Santander **	63.0	3%	6%	1%	**7%**	29.4	**63**	**8%**	42.8	**63**	**10%**	**69.6**	**70**
BBVA	37.9	3%	6%	1%	**7%**	4.5	**38**	**8%**	12.0	**38**	**10%**	26.9	**38**
Intesa	17.2	3%	6%	1%	**7%**	1.8	**17**	**8%**	7.7	**17**	**10%**	**19.6**	**20**
ING	28.4	3%	6%	1%	**7%**	**29.5**	**30**	**8%**	**40.4**	**40**	**10%**	**62.3**	**62**
UBI	5.5	3%	6%	1%	**7%**	1.2	**6**	**8%**	2.5	**6**	**10%**	4.9	**6**
Caixabank	10.1	3%	6%	1%	**7%**	6.5	**10**	**8%**	**10.4**	**10**	**10%**	**18.1**	**18**
Mediobanca	3.5	3%	6%	1%	**7%**	-	**3**	**8%**	-	**3**	**10%**	0.0	**3**
CM11-CIC	6.9	3%	6%	1%	**7%**	6.6	**7**	**8%**	**11.7**	**12**	**10%**	**21.9**	**22**
Sum							**402**			**454**			**655**

NB: The data in shaded grey on the right of the table shows what type of requirement is the most demanding (RWAs or leverage).
1 DB/CMZB: We include here retroactively juniorised German senior debt based on the government's 2015 proposal
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Source: Bank data, Natixis

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